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C O N F I D E N T I A L SECTION 01 OF 02 ALMATY 002273

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DEPT FOR EB/ESC; SCA/PO (MANN); SCA/CEN (MUDGE)
USTDA FOR DAN STEIN

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TAGS: ENRG EPET KZ PGOV PREL
SUBJECT: KAZAKHSTAN: TENGIZ UPDATE

REF: A. 05 ALMATY 4264

¶B. ALMATY 960

Classified By: Pol-Econ Chief Deborah Mennuti; reasons 1.5(b) and (d).

¶1. (C) Summary: New TengizChevrOil (TCO) General Director Todd Levy discussed Tengiz developments with Econoff on June 22 in Atyrau. Levy told Econoff that the project to double TCO oil production (to 500,000 barrels/day) would likely be delayed three months, until July 2007, due primarily to a shortage of skilled workers. TCO's recent deals with the Azeris and with a private Kazakhstani terminal operator to ship short-term (pre-CPC expansion) Tengiz volumes through the BTC had recently come undone, forcing TCO to start negotiations anew. The GOK has recently increased its pressure on TCO to eliminate the company's sulfur stockpiles, threatening to increase fines radically if TCO does not develop a more ambitious sulfur removal plan. Finally, Levy told Econoff (in strict confidence) that exploratory wells had revealed significant oil reserves (his rough estimate: 100 million barrels) and "sweet" (non-sulfurous) gas at a new, onshore field. End summary.

Tengiz Expansion Likely Delayed Until 3Q 2007

¶2. (C) New TCO General Director Todd Levy briefed Econoff on the status of TCO's "Second Generation Production (SGP) / Sour Gas Injection (SGI)" project, which will nearly double TCO's current production of 280,000 barrels/day. Levy told Econoff (in confidence) that, while TCO was publicly targeting March 2007 for project completion, July 2007 was a more realistic date. The principal cause of the delay, Levy explained, was that TCO's contractors could not find sufficient workers to staff the project, despite the fact that TCO was offering more and more incentives.

¶3. (C) Levy explained that the SGI facilities would undergo critical tests in the coming months. Of the additional gas that would be produced by SGP, he said, roughly two-thirds would be treated in newly-built gas processing and sulfur-removal facilities, while one-third would be reinjected as untreated, "sour" gas. There was no industry precedent for injecting such high-pressure, highly-sulfurized gas at such depths, Levy observed. The SGI facilities had been completed, he said, and TCO would spend the next five months testing (and debugging) the system with sweet gas before beginning processing of the poisonous sulfurous gas.

Temporary Transportation Options Up in the Air
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¶4. (C) Levy voiced frustration with arrangements to transport second-generation Tengiz oil to market in the years before CPC expansion is completed (Ref A). Two-thirds of the SGP oil would be railed to Odessa, he said, and Kazakhstan's national railway company, KazTemirZholy, seemed to be expanding the necessary track on schedule. Far more problematic, Levy noted, was the one-third of SGP oil that would be exported via the BTC pipeline. At one point, he explained, TCO had signed a contract with SOCAR to ship TCO oil via the BTC; however, the Azeri authorities had subsequently voided the contract, telling TCO that their interlocutors had not possessed the authority to negotiate the deal. Lately, Levy said, the Azeris had been telling TCO that "the economics of the pipeline didn't foresee the shipment of Third Party oil" -- a worrisome, and in Levy's view, not fully comprehensible stance.

¶5. (C) Levy told Econoff that TCO lawyers hadn't yet seen a copy of the newly-signed IGA, adding that he was anxious to confirm that the agreement covered oil shipped from any source, and not just Kashagan. (Note: By Econoff's read, it does. End note.) TCO had also reached an agreement regarding TCO oil shipments with Timur Kulibayev's Mobilex Aktau terminal, Levy explained, only to learn that a group backed by Prime Minister Akhmetov had won an "invisible power struggle" against Kulibayev and KMG, and had now replaced the latter in negotiations. Despite these setbacks, Levy was able to laugh: "at least we have fewer problems that (Kashagan operator) AGIP KCO."

GOK Pushes on Tengiz on Sulfur Removal

¶6. (C) Levy told Econoff that the GOK continues to pressure TCO to reduce its sulfur stockpiles (Ref B). Levy explained

that TCO had thought the two sides had reached an agreement by which TCO would expand its sulfur handling capabilities (both to transform the powder to granules, and to transport the granules to market) in order to remove 125% of its annual sulfure production, thus eliminating existing stockpiles by
¶2023. However, the GOK had recently informed TCO that 2023 "wasn't fast enough," warning that the GOK would "create incentives" for TCO to remove the sulfur more quickly. (The "incentive," Levy indicated, might be annual fines, based not just on the incremental sulfur added to the stockpiles each year, but on the entire volume of stockpiled sulfur.)

¶7. (C) Levy explained that TCO and GOK authorities would soon meet to negotiate a new solution. However, it looked like the GOK might be push for the annual removal of 150%, or even 200%, of production. To remove 150%, Levy noted, would require much more capital investment -- and an entirely new plan -- than 125%, while advancing the project's completion by only four years, to 2019. In fact, Levy added, the GOK's approach made little economic sense at all, as the GOK would end up paying for a large part of any removal project through lost royalties and taxes and a reduced KMG profit share. In the end, Levy said, he could only conclude that the GOK's objection to the sulfur was based on genuine (if misguided) environmental concerns.

Little Enthusiasm for Trans-Caspian Gas Pipeline
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¶8. (C) Asked his view of a proposed Trans-Caspian gas pipeline, Levy laughingly said, "I'd rather have another oil pipeline, thank you." Reinjection provided TCO with its best gas value, he said, and would probably continue to do so for the forseeable future. Not only did reinjection help maintain oil reservoir pressure, he explained, it also avoided the (costly) necessity of gas processing and sulfur removal. Levy admitted, however, that it was hard to predict the future effectiveness of reinjection, as reinjected gas often found an unanticipated path back to the surface, where

it had to be treated and sold. TCO would soon undertake a new survey of the underground reservoir with an eye to estimating the effectiveness of reinjection, Levy said. After the study's completion, TCO would likely know far more about possible gas volumes available for export.

Chevron's Promising New Onshore Discovery

¶9. (C) Levy told Econoff (in strictest confidence) that Chevron executives were "beside themselves" with excitement over the results of exploratory drilling at a new, onshore field. The field "could hold 100 million barrels," Levy estimated, had "good porosity," and, perhaps the best news of all, contained sweet, non-sulfurous gas. Chevron's discovery would be the subject of a press release soon, Levy said, but in the meantime was being kept secret even from the majority of company employees.
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